

April 23, 2015

Gerard Poliquin  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, Virginia 22314-3428

Re: Proposed Rule – Risk-Based Capital

Dear Mr. Poliquin:

The National Credit Union Administration (NCUA) Board (the Board) is proposing to subject complex credit unions, institutions with at least \$100 million in assets, to a risk-based capital requirement. The proposed risk-based capital requirement will replace the current risk-based net worth requirement.

The Board believes that credit unions taking certain risks should hold capital commensurate with those risks. As noted in the Federal Register Notice, “[i]n general, risk-based capital standards increase capital requirements at those institutions whose asset portfolios have, on average, higher risk. Conversely, risk-based capital standards generally decrease the cost of holding capital for institutions whose strategies focus on lower risk activities.”

I am supportive of the Board’s position that riskier institutions should hold more capital.

However, my comments will address two issues – the removal of the 1.25 percent of risk asset limit on the amount of the allowance for loan and lease losses (ALLL) that can be included in the risk-based capital ratio numerator and the elimination of the Individual Minimum Capital Requirement (IMCR) provision.

***The Board Should Not Remove the 1.25 Percent Limit on ALLL***

In its risk-based capital proposal, the Board is proposing to remove the 1.25 percent of risk asset limit on the amount of ALLL that can be included in the risk-based capital ratio numerator. I believe the Board should keep the limit on ALLL to 1.25 percent of risk assets in determining the risk-based capital ratio numerator.

The position of the Board differs from the stance taken by the Basel Committee on Banking Supervision (the Committee).

In a 1991 amendment to the Basel Capital Accord, the Committee noted:

"General provisions or general loan-loss reserves are created against the possibility of losses not yet identified. Where they do not reflect a known deterioration in the valuation of particular assets, these reserves qualify for inclusion in tier 2 capital. Where, however, provisions or reserves have been created against identified losses or in respect of an identified deterioration in the value of any asset or group of subsets of assets, they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess

an essential characteristic of capital. Such provisions or reserves should therefore not be included in the capital base."

In other words, if the loan loss reserves are established for identifiable losses, then they do not possess the essential characteristic of capital -- the ability to absorb unidentified losses -- and should not be included in the capital base.

The Committee further noted in the original 1989 Capital Accord that "it is not always possible to distinguish clearly between general provisions (or general loan-loss reserves) which are genuinely freely available and those provisions which in reality are earmarked against assets already identified as impaired."

This inability to distinguish between identified and unidentified losses resulted in capping the amount of ALLL being counted as capital at 1.25 percent of risk assets.

Moreover, fears that limiting ALLL to 1.25 percent of risk assets will create a disincentive for complex credit unions to fully fund the ALLL above the 1.25 percent ceiling are ill-founded. A complex credit union is bound by generally accepted accounting principles to fully fund its ALLL. Not doing so, would constitute unsafe and unsound practices.

Furthermore, this provision to remove the cap on ALLL would overstate the amount of capital that complex credit unions have available to absorb unexpected losses. It will also make the comparison between bank and credit union risk-based capital ratios more difficult.

Therefore, the Board should keep the limit on ALLL to 1.25 percent of risk assets in determining the risk-based capital ratio numerator.

### ***The Board Should Retain the IMCR Provision***

The National Credit Union Administration (NCUA) Board is proposing to eliminate the IMCR provision that was in the original version of its risk-based capital proposal.

The original proposal would have introduced rules and procedures to permit the Board, on a case-by-case basis, to impose an IMCR that exceeds the risk-based capital requirement that otherwise would have applied to a credit union.

In justifying the elimination of the IMCR, the Board noted that NCUA has several avenues to address any deficiencies in a credit union's capital level relative to its risk. This would include potentially reclassifying the credit union into a lower net worth category, determining that capital level is not commensurate with the level or nature of the risks to which the credit union is exposed, or using other supervisory authorities to address unsafe or unsound conditions or practices.

However, the elimination of the individual minimum capital requirement provision is at odds with the position of other federal banking regulators. Bank regulators have the discretion to require a bank to hold an amount of regulatory capital greater than otherwise required under its capital rules if a bank regulator determines that the institution's capital requirements under its capital rules are not commensurate with the institution's credit, market, operational, or other risks.

In addition, the requirement of a complex credit union to hold a minimum level of capital greater than otherwise required under the agency's capital rules would most likely require a formal agreement between the NCUA and the credit union. Such a formal agreement would require the agency to publish its action, increasing transparency. The publication of this information would be extremely useful for current and prospective credit union members in evaluating the safety and soundness of the credit union under an IMCR.

Therefore, the Board should not eliminate the IMCR provision.

If the agency has any questions regarding my comments, I can be contacted at [klcuwatch@gmail.com](mailto:klcuwatch@gmail.com).

Sincerely,

Keith Leggett

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